BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
JOHN DEERE PLOW COMPANY OF MOLINE)

Appearances:

For Appellant: Valentine Brookes, Attorney at Law

For Respondent: John S, Warren, Associate Tax Counsel

O P I N I O N

This appeal is made pursuant to Section 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protests of John Deere Plow Company of Moline to proposed assessments of additional franchise tax in the following amounts for the indicated income years:

Income years ended October 31	Amount
1938	$ 7,774.98
1939	8,681.33
1940	12,021.71
1941	11,380.17
1942	10,713.79
1943	5,825.21
1944	2,386.88
1946	291.71
1948	2,502.66
1949	38,660.66
1950	45,969.32
1951	25,822.57

Appellant made a payment of $111,302.25 against these assessments at the time that its protests were pending before the Franchise Tax Board. Pursuant to Section 26078 of the Revenue and Taxation Code, the appeal will be treated as from the denial of a claim for refund in the amount of the payment.

Since the filing of this appeal, the Appellant has conceded that the action of the Franchise Tax Board with respect to the years ended October 31, 1938, to 1941, inclusive, should be sustained.

With respect to the income years ended October 31, 1945, and 1947, the Franchise Tax Board, acting under Section 26073 of the Revenue and Taxation Code, certified overpayments of $2,523.40

and $6,817.58 to the State Board of Control for approval of the refunding or crediting thereof to Appellant. Section 26073 provided that no refund or credit of an overpayment may be allowed after the expiration of a prescribed period of limitations "unless before the expiration of such period a claim therefor is filed by the taxpayer, or unless before the expiration of such period the Franchise Tax Board has certified the overpaymentto the State Board of Control for approval of the refunding or the crediting thereof.') Subsequent to the certification of the overpayments to the State Board of Control and the expirationn of the statutory period of limitations, Appellant filed claims for refund for the two years in amounts greater than the amounts so certified.

Both Appellant and Respondent agree that the failure of Appellant to file timely refund claims precludes the allowance of credits or refunds for the years ending in 1945 and 1947 in excess of the amounts certified to the State Board of Control. The actual amount of the overpayment in each year turns upon the determination of substantive issues common to those years and other years under appeal. We are asked, accordingly, to decide whether the credit or refund to be made to Appellant shall be the aggregate of the amounts certified to the Board of Control or some lesser sum.

The administrative authority of this Board under the Bank and Corporation Tax Law is limited to the determination of an appeal from the action of the Franchise Tax Board on a protest to a proposed assessment, the denial of a claim for refund or the disallowance of interest on a claim for refund. Since the overpayments in question may be credited or refunded, if at all, only by virtue of their certification to the Board of Control for approval, the Franchise Tax Board has taken no action from which an appeal to this Board is authorized. The years ending in 1945 and 1947, accordingly, are not open to our inquiry.

Appellant is a wholly owned subsidiary of Deere and Company. Deere and Company has several other wholly owned subsidiaries. The activities of the parent and subsidiaries are, except as hereafter noted, concededlyintegrated into a single unitary business and Appellant's income is determined by computing the combined net income of the entire group of corporations and allocating a portion thereof to Appellant by an allocation formula.

For the income years ended October 31, 1942, 1943, 1944 and 1945 Respondent has considered the Iowa Transmission Company to be one of the corporations engaged in the unitary business carried on by the Deere group. Iowa Transmission Company is a wholly owned subsidiary of Deere and Company but Appellant contends that the nature of the business of Iowa Transmission Company was such that it should not have been considered part of the unitary business of the Deere group.

The business of the Deere group was the manufacture and sale of agricultural machinery and equipment. Iowa Transmission Company was a new corporation formed early in World War II to manufacture transmissions for military tanks and other war material. It acted both as a nrime contractor to the United States and Canadian Governments and as a subcontractor to such a prime contractor. It purchased most of its gears from John Deere Tractor Company, one of the Deere group. The gears were the major component of the transmission. It conducted its manufacturing operations with equipment owned by the United States Government and in a plant leased from John Deere Tractor Company.

The principle that the California income of a corporation conducting a unitary business in more than one state generally should be determined by an allocation formula rather than by separate accounting was clearly established by Rutler Bros. v. McColgan, 17 Cal. 2d 664, aff'd, 315 U.S. 501. The principle was extended to a family of cornorations in Edison California Stores, Inc. v. McColgan, 30 Cal. 2d 472. In the Butler Brothers case it was said that whether formula accounting or separate accounting is to be used depends entirely on the nature of the business conducted and that where two allegedly separate businesses are being carried on, separate accounting is permissible only where the two are truly separate and distinct so that the segregation of income may be made clearly and accurately. The court in the Edison case stated that a business is unitary if one portion of it depends upon or contributes to the other.

That the business conducted by the Iowa Transmission Company was a part of the unitary business of the Deere group is indicated by the established facts that Iowa Transmission Company was a wholly owned subsidiary of Deere and Company, that it operated in a plant leased from another subsidiary of Deere and Company and that it purchased the major component of its products chiefly from that subsidiary. It is, moreover, readily inferable from these facts that the experience of the Deere group in making transmissions for tractors contributed to Iowa Transmission's securing the initial military contracts, that Iowa Transmission benefited from key personnel being transferred to it from other corporations in the Deere group, that Iowa Transmission benefited from having an assured supply of gears made by a corporation on which it could exert influence through the common parent in order to secure proper quality of product and timing of deliveries, and that Iowa Transmission benefited from calling on other organizations in the Deere group for advice and assistance in solving particularly difficult problems.

Respondent's conclusion that Iowa Transmission's business was part of the unitary business of the Deere group is presumptively correct and it is for the Appellant to show the incorrectness thereof. Appellant has offered nothing which overcomes the

established facts or the logical inferences to be drawn from them. Accordingly, the conclusion of the Respondent must be sustained.

Respondent has included Iowa Transmission's sales in the denominator of the sales factor at 50% weight. Respondent states that where a taxpayer has both "war sales," that is, sales of war material pursuant to government contracts, and civilian sales Respondent has consistently taken the war sales into consideration at 50% in the sales factor, It points out that here the unitary group as a whole had both war and civilian sales,

Respondent states that one reason for its practice is that the sales effort involved in making military sales is substantially less than the sales effort in making civilian sales and the 50% weight reflects such reduced sales effort. In view of the argument by Appellant that the cost of selling: civilian goods was very low due to wartime scarcities it is doubtful whether Respondent's theory forms a substantial basis for the application'of the rule to Appellant. We do not decide this point, however, for we find Respondent's action supported on another theory.

Respondent puts forth as another basis-for its weighting war sales at 50% the fact that the sales factor of the allocation formula is intended to serve as a counterbalance to the property factor and to some extent to the payroll factor. Normally, sales are allocated to outlets where the taxpayer's employees expend some effort in making individual sales. Thus, the sales are largely allocated to the state in which the market is located.

With war sales, it would be a distortion to allocate them to Virginia just because a taxpayer's representatives travel to the Pentagon to secure a single contract under which-numerous items are produced and sold. In practice, therefore, Respondent has allocated war sales to the place of manufacture. This allocation, however, distorts the formula in favor of the place of manufacture and to lessen the distortion, Respondent weights war sales at 50%.

It must be recognized that Respondent has been given a considerable amount of discretion to prescribe a formula for the allocation of income. El Dorado Oil Works v. McColgan, 34 Cal. 2d 731, appeal dismissed 340 U.S. 801, 885; Pacific Fruit Express Co. v. McColgan, '67 Cal. App. 2d 33. We find Respondent's explanation to be a reasonable and acceptable method of handling a difficult problem and, therefore, sustain its weighting of war sales at 50%.

In computing the amounts to go into the property factor, Respondent considered that construction in progress had not yet been used in the unitary business, had not vet contributed to income and should be eliminated from the property factor,

Appellant does not disagree with this principle but is in disagreement with Respondent concerning the amount of construction in progress. This-issue affects the tax for the income years ended October 31, 1946, 1948 and 1951.

Appellant has submitted evidence concerning the amount of construction in progress at the various plants and offices of the Deere group for the income year ended October 31, 1951. Appellant and Respondent have stipulated that any ratios developed from this evidence map be applied to the income years ended October 31, 1946 and 1948.

We find that the amount of construction in nroeress for the income year ended October 31, 1951, all of which was outside of this State, was $1,586,336. The net additions to the tangible assets of the Deere group during the income year ended October 30, 1951, amounted to $6,192,080. Therefore, construction in progress for the year was 25.62% of the net additions during the vear and pursuant to the stipulation the construction in progress for the income years ended October 31, 1946, and 1948, should be computed as 25.62% of the net additions during those years.

Appellant and John Deere Killefer Company (hereinafter called Killefer) are the only corporations in the Deere group which are engaged in business in California. Each is a wholly owned subsidiary of Deere and Company. For each of the income years ended October 31, 1946, 1948, 1949, 1950, and 1951, Respondent computed the taxable income from California sources Of the Deere group and the tax thereon, subtracted the tax previously paid by Appellant and Killefer and assessed the entire difference to Appellant. Appellant objects to this procedure and asserts that part of the additional tax should have been assessed to Killefer. Respondent contends that Appellant is estopped to question the procedure.

The question of the tax liability of the Deere group was the subject of numerous conferences and letters between representatives of Appellant and Respondent over a long period of time. On December 1, 1953, Respondent made the following statement among proposed adjustments contained in a letter to Deere and Company directed to the attention of representatives of the Deere group who were handling the California franchise tax problems:

> Notices of Proposed Additional Assessment for all years will be issued against the John Deere Plow Comnanv of Moline. unless vou would prefer that the additional tak be broken down and allocated to the various corporations of the eroup that are qualified and doino business in California.

the letter concluded with the statement that "Your comments concerning the above-proposed basis for settlement will be appreciated." In subsequent correspondence and conferences, Appellant's representatives raised no objection to the above-quoted proposal. No objection was raised until this appeal was filed, after the assessments were issued and after the time for making new assessments had expired.

It is pertinent that the correspondence was always with Deere and Company, the parent of Appellant and Killefer. This would indicate that the Deere representatives were concerned with the total amount of tax the Deere organization was required to pay and were less concerned or unconcerned with strictly separating the various corporate entitles and assigning to each its proper portion of the total tax liability.

Under all the circumstances we have concluded that the failure of Appellant to respond to Respondent's letter of December 1, 1953, was equivalent to assent to the procedure proposed. Such assent could, of course, have been rescinded, but only if there still remained reasonably sufficient time for Respondent to make an assessment against Killefer. Respondent reasonably relied on Appellant's silence as assent and, accordingly, Appellant may not now question the procedure.

O R D E R

Pursuant to the views expressed in the Opinion of the Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to Sections 25667 and 26077 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protests of John Deere Plow Company of Moline to proposed assessments of additional franchise tax and in denying the claims of John Deere Plow Company of Moline for refund of franchise tax for the income years ended October 31, 1938, 1939, 1940, 1941, 1942, 1943, 1944, 1946, 1948,

1949, 1950 and 1951, be and the same is hereby modified with respect to the income years ended October 31, 1946, 1948, and 1951, as follows: the denominator of the property factor of the allocation formula is to be recomputed by eliminating therefrom the amounts of construction in progress as specified in the Opinion of the Board on file herein; in all other respects, the action of the Franchise Tax Board is sustained.

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that the Appeal of John Deere Plow Company of Moline for the income years ended October 31, 1945: and 1947, be and the same is hereby dismissed.

Done at Sacramento, California, this 13th day of December, 1961, by the State Board of Equalization.

John W. Lynch, Chairman

Geo. R. Reilly, Member

Paul R. Leake, Member

_____, Member

_____, Member

ATTEST: Dixwell L. Pierce, Secretary